Development and Stabilization in Small Open Economies: Theories and Evidence from Caribbean Experience

Synopsis of my new book

This book analyses and explains the nature of the economies of small countries and territories. It includes an assessment of material prosperity in 41 small open economies worldwide, with case studies focusing on the Caribbean and Central America, and a review of the development of their economies in recent decades. The volume recommends a suite of economic policy tools for the management of these economies, demonstrating how these may best be employed in economies that live and breathe through international commerce. Among observations of interest is the fact that the devaluation of the local currency of a small nation makes the country worse off; even a currency that maintains its value is little more than a trophy, of little value if it is not readily convertible into US dollars. Also, that while government policies affect international competitiveness and a small country's growth prospects, more important is how governments use additional resources to improve the quality of health and educational services. Moreover, economic windfalls such as the discovery of mineral resources seldom bring prosperity commensurate with their economic value, and never in the short run.

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Excerpts from Chapter 1

The banner headline in the Barbados *Sunday Sun* newspaper of October 28, 2012 read “IMF Clash”, under juxtaposed photos of Christine Lagarde, then Managing Director of the International Monetary Fund, and myself, Governor of the Central Bank of Barbados. The article reported on a leaked transcript of a meeting in Tokyo, Japan, two Sundays earlier, between the Managing Director and Caribbean delegates to the annual meetings of the IMF and World Bank, which had concluded in the Japanese capital that week. The transcript “showed a vigorous debate between Worrell and Lagarde, a former French minister of finance, over the merits of devaluation, and how economic growth could be achieved”, according to the article. Lagarde’s experience would have been that when the value of the euro falls relative to the dollar, travel to France becomes more affordable, resulting in a surge of visitors to that country. In contrast, everyone in the Caribbean knows that airfares to the region, hotel rates, restaurant menus, taxi fares, access fees to tourist attractions, souvenirs, spa treatments, hair braiding and all services targeted at the tourist business, are priced in US dollars. When the value of the Trinidad and Tobago currency fell from 4.25 to the dollar to 6.00 in 1993, the taxi fare from Piarco International Airport to downtown Port-of-Spain increased from 95 in local currency to 132, but it remained unchanged in US dollars at US$22. The prices at which small economies sell to the international market are set, usually in US dollars, and are unaffected by changes in the value of the local currency.

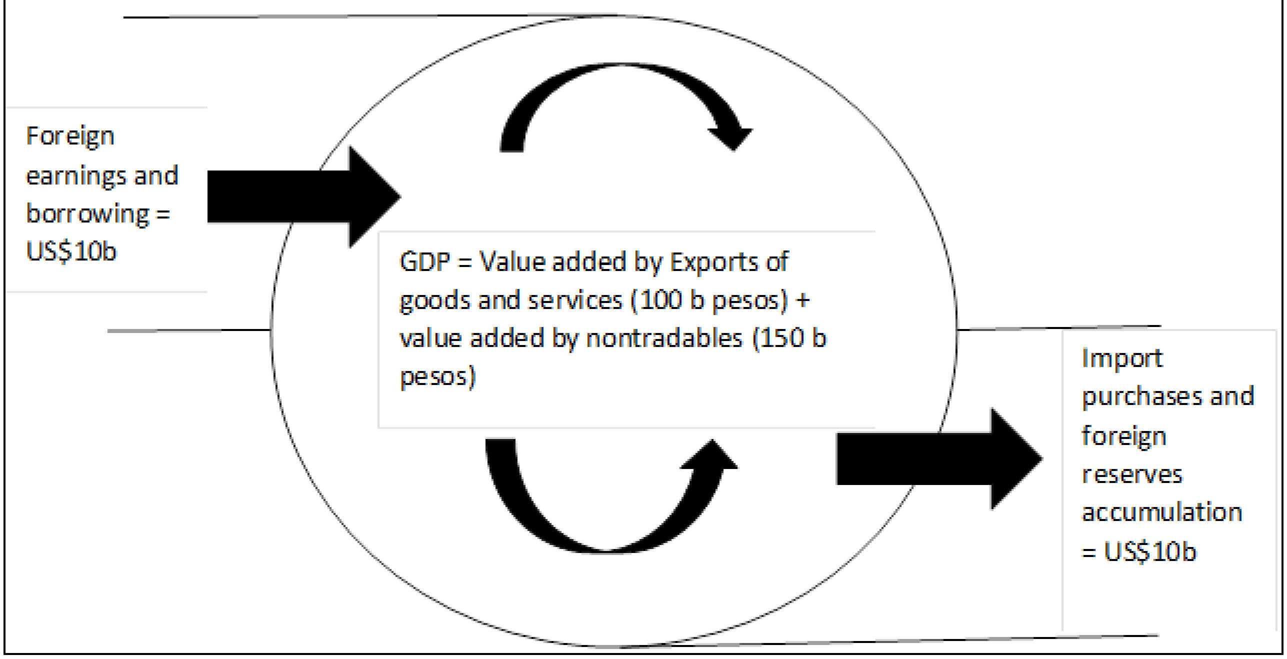
The fact that devaluation has no effect on the prices at which tourist services and all other exports from small open economies are sold is baked into all economic models developed in the Caribbean, but this essential feature is absent from the models used by IMF staff and others to assess Caribbean economies, to comment on policies and to conduct negotiations for programmes of financial assistance. That is no doubt because the builders of conventional models base their specifications on their experiences, which are of European and North American countries. Very recently mainstream economists have come to recognise what has been termed “the dominant currency paradigm”; dominant currency pricing is a feature that defines economies of the size with which this book is concerned.

Another distinctive feature of small economies is that their international commerce operates, in terminology which has become familiar in the context of small scale renewable energy production, on a “buy all/sell all” basis. Because of a small population and a limited range of skills, resources and productive capacity, there are only a handful of goods and services which small economies can produce in quantity at internationally competitive prices. Their most efficient strategy is to export everything they produce and buy everything they need, all of which they can buy abroad more cheaply than they can produce at home, if they are able to produce the item at all. The only things produced and consumed in an efficient small economy are government services, public utilities, distribution and other nontradables. The stability of the small economy is secured by a balance between what they earn from foreign sales and prudent foreign borrowing, and what they spend on purchases from abroad. The growth of the economy depends on selling more abroad, through increased productivity and increased capacity to produce competitive products and services. (Pages 1 – 2.) …

The small open economy is fuelled by foreign currency

Figure 1.1 illustrates the mechanism of a small open economy. Its internationally competitive tourism and exports earn foreign currency, and thanks to the productivity of local labour and the attractiveness of the local investment climate it attracts foreign investment. Together these sources provide US$10 billion of foreign exchange, which is converted to local currency at the exchange rate of 10 pesos to the dollar, generating an additional 150 billion in pesos of added value by public utilities, transport, communications, banking and insurance services, wholesale and retail activity, for a total GDP of about 250 billion pesos. This spending in turn generates imports of fuels, vehicles, equipment, building

Figure 1.1 The Small Open Economy



materials and consumer items. Any surplus which is left of the US$10 billion inflow is added to the country's store of foreign reserves, invested by the central bank with the US Federal Reserve Bank in New York. (Page 5.)

Chapter abstracts

1. Introduction: A novel approach to policy making in small open economies

Although policy makers in small open economies employ many of the tools familiar to authorities in large economies, the way they use the tools and the economic targets of policy are different. That is because, unlike large economies, small nations specialise in a limited range of exports and tourism and other services, the receipts from which they use to buy all their needs from abroad. With their small size and limited economic resources they can match the international competition only in these few activities. This book works through the implications of the fact that small open economies are fuelled by foreign currency, which they expend in acquiring goods and services for domestic consumption and investment. We define the objective of economic policy as the improvement in well-being of the average household, rather than the growth of GDP. The United Nations Development Programme's Human Development Index provides a readily-available measure of material well-being. The use of the HDI gives guidance for policies that are attuned to the needs of the population, and the success of policy will show up in improved health and education outcomes, as well as increases in the purchasing power of average incomes. Economic policy making is the art of influencing and motivating the behaviour of thousands and millions of economic agents in directions that result in behaviour that produces the outcomes targeted by policy makers. To get best results, policy makers must use a model of the economy that closely maps how one factor impacts another in order to design a data-driven, well-articulated economic strategy for the medium term, with an action plan and benchmarks for tracking progress and making changes to stay on target.

2. Human development and economic stabilisation: Comparative SOE experiences

Two-thirds of the 41 small open economies chosen for analysis in this book have Human Development Indices which put them in the categories of High and Very High Human Development. The remainder are in the Medium category, with only one, the Gambia, with a score below 0.500, the cut-off below which countries are classified as having Low Human Development. Iceland is the country that tops the list with the fourth highest score of all countries in the 2020 Index. Mauritius is rated the best-performing in our sample: not only does it sit in the highest category but the country has also made the largest gain in human development in the past 30 years. Comparative analysis among the 41 countries indicates that improvements in health and education have a much more powerful impact on the HDI score than does an increase in purchasing power of the same percentage. We infer that although growth is needed to provide additional resources, the effectiveness with which resources are deployed to improve health and educational achievement is more important than the rate of growth. Capsules of the growth performances of all 41 countries revealed the expected variety, but in general we find that the impact of downturns in global economic cycles appears to be less pervasive than is usually assumed. Also, only prolonged slow growth and deep contraction retard improvement in the HDI score. Extreme economic volatility may also depress the HDI score, but such volatility is rare. Wars and civil strife cause lasting damage, but hurricanes and natural disasters have no lasting impact on the growth rate.

3. Selected country experiences

Barbados was transformed from an economy based on export agriculture with poor human development in 1945, to one based on tourism, with an HDI score that puts the country in the top category of human development. Although gains have continued to be made in the years since Independence in 1966, the essential transformation was achieved in the 1950s and 1960s. Government budgeting was characterised as prudent in the early years of Independence, and the public services demonstrated relatively high productivity. Government savings contributed one-third of capital spending for the period from 1945 to

1980. In stark contrast, the public sector was described in 2016 as overstaffed, poorly skilled and with low productivity. The relaxation of fiscal discipline from the mid-1980s resulted in a balance of payments crisis which required deep economic contraction in 1991, and that pattern was repeated from 2013 to 2018, with another balance of payments crisis in that year. The economies of the Eastern Caribbean Currency Union (ECCU) have maintained an advantage over the Caribbean average HDI score in the past two decades, a period during which they completed the switch from export agriculture to tourism. The ECCU experience shows that large current account deficits are sustainable over many years, and healthy levels of foreign reserves bear testimony to the region's resilience in the face of hurricanes and other natural disasters. The economic transformation of the Dominican Republic came with political stability and the development of the tourism industry. Trinidad and Tobago, the insular Caribbean's major oil exporter, recorded modest success in managing volatile foreign earnings, particularly in the 1970s, when a major new industrial zone was established with the proceeds of an oil bonanza. Belize bettered the average Caribbean HDI score on the basis of tourism revenues, plus exports of sugar, fruits, clothing and other manufactured goods. Cuba suffers from a combination of geo-political victimisation and bad economic management. Health and education indicators are outstanding, but income levels are low, productivity is falling and the outlook is discouraging. The strength of an economy which had benefited from long periods of sustained growth and sound finances enabled Iceland to emerge unscathed from what was, in relation to its GDP, the worst single country financial crisis triggered by the global recession of 2008. Mauritius made large improvements in well-being as a result of tourism, clothing and textile exports and by prudent fiscal policies since 1987.

4. The Sources of Foreign Exchange in Caribbean and Central American Countries

Chapter 4 tells the stories of changing production structures in the foreign earnings sectors of countries and in foreign finance in the Caribbean and Central America. We chart the manner in which the changes came about and the main factors influencing these developments. In doing so, we explore the associated themes of labour productivity, inflation, migration into and out of the region and the exploitation of natural resources. The sectors and activities discussed in this chapter are tourism, other services such as data processing, call centres and international business services, exports of clothing, processed food and other manufacturing, mineral and other primary extractive industry exports and remittances. The Bahamas, Barbados and the countries of the Eastern Caribbean Currency Union derive most of their foreign earnings from tourism and related activities. Tourism was also the largest contributor to inflows in Cuba and Jamaica. The Dominican Republic, along with three Central American countries (Costa Rica, Nicaragua and Panama) are mainly exporters of manufactured goods such as pharmaceuticals and medical equipment. Exports of bananas, sugar, coffee, fruits and other agricultural products are the largest sources of foreign earnings for Guatemala and Honduras, followed by workers' remittances. Trinidad and Tobago is the only country in this region which exports petroleum and related products, accounting for approaching 90 per cent of inflows, although in the early 2020s Guyana is poised to become the second oil exporter. There are two countries for which remittances have become the main source of foreign currency, El Salvador and Haiti, tragically in both cases as a result of social and political instability. International business services, including legal, accounting, insurance, finance and marketing, are now of importance mainly in the Cayman Islands, Bermuda and smaller UK dependencies in the Caribbean.

5. Economic integration in the Caribbean

The international competitive success of the Caribbean, which rests mainly with tourism, owes little to official policy and nothing to regional cooperative efforts. The Caribbean has become more integrated socially, culturally and, on a sub-regional basis economically, at the same time that the official institutions have lost their credibility. The region has developed a small but remunerative cultural industry that fuels economic activity of Caribbean people in ways which economic statistics do not record. Opportunities for migration within the region, to the mutual benefit of sending and receiving countries, have grown in response to employment opportunities, even though the limited and impossibly bureaucratic formal arrangements for intra-regional migration have proven completely ineffective. There has been an intensification of financial integration within the Caribbean. The facts of geography dictate that the Caribbean has an American destiny, and the economic weight of the US makes it inevitable that the region's economic fortunes depend on the nature of its relationships with that country. It may however be argued that the Caribbean has not used the unequal relationship to its best advantage because of the pursuit of futile attempts to resist American influence, rather than finding ways to take advantage of the relationship to further the goals of the Caribbean people. What emerges from an overview of Caribbean economies today is a picture of exceptional achievement by the people of the region, in virtually every field of human endeavour, and the achievement of levels of living in the region that, with few exceptions, are not far short of those typical of countries in Europe and North America. In contrast, the landscape of policy and governance is one of unrelieved failure to attain the often lofty intentions of the region's independent nation-states. In order to fully appreciate the sources of improvements in Caribbean well-being, it is helpful to think of the Caribbean as including the diaspora, up to now mainly in North America and Europe, but increasingly spreading to the Middle East, Asia and elsewhere. The diaspora is also perhaps the most powerful instrument of integration of the Caribbean nation.

6. A Policy Model for Stabilisation and Growth in the Small Open Economy

This chapter presents a behavioural model which incorporates the distinguishing features of small open economies (SOEs): their growth depends on investment in their capacity to produce internationally competitive tradable goods and services, sold abroad at ruling world prices; there is no substitutability between the tradables they sell to earn foreign exchange, the imports they need to sustain production and lifestyles, and government services and other nontradables; and their financial markets cannot be insulated from the international financial markets which enable their external commerce, the lifeblood of their economies. The key to successful policies for stable growth and long term prosperity in SOEs is fiscal policy designed to manage aggregate demand with a view to external balance and a stable exchange rate, while at the same time deploying tax, expenditure and government borrowing policies to sustain and improve international competitiveness. In this chapter the effectiveness of this strategy is brought to light with the use of the SOE-specific model and its conclusions are compared with conventional wisdom.

Growth in the SOE comes by way of nurturing and developing the products and services in which the country has an established international competitive advantage and following up selectively on clues as to coming activities which show promise for sales to foreigners, given the society's endowments. Economic stabilisation in the SOE is attained by ensuring that the external accounts are always in balance with the expected levels of investment and output

7. Targeting the exchange rate using fiscal policy to adjust aggregate expenditure

This chapter proposes that small open economies treat the foreign currency market as one where the exchange rate is fixed in advance, much like prices in a supermarket, and recommends that government manages tax policy, its own expenditure and its finances to moderate total imports in line with the amount of foreign currency that is available. Arguably, this is the only approach that enables the government of a small open economy to avoid a steep devaluation of the local currency under all circumstances. We offer guidelines for fiscal policies to improve productivity in the public service, to respond to international shocks such as the COVID-19 pandemic, to correct for the impact of election cycles on fiscal balances and to arrest runaway inflation in property prices. The advantage of using fiscal tools is that they are varied and flexible, and strategies may be tailored to the circumstances by calibrating each tool to fit into the overall picture. The tools also have the advantage that they comprise actions which are directly within the government's purview – that is, direct spending – and actions which are designed to affect the behaviour of actors in the private sector, which offers a wealth of options for custom design to fit each circumstance. Using the balance of payments to define the overall stance of fiscal policy gives us an objective measure of fiscal space, depending on the surplus of foreign currency over the demand for imports which is available to support additional stimulus. The chapter offers case studies of adjustment based on Caribbean experience, contrasting the approach using fiscal policy to manage the external balance with conventional strategies.

8. International competitiveness with an exchange rate anchor

This chapter discusses how the SOE may devise a growth strategy to increase investment by stimulating international competitiveness. Suggestions for the design of tax systems to stimulate competitiveness are drawn from Caribbean experience, beginning with the design of the tax system. Because foreign currency is essential for growth in small open economies, the corporate tax system should be biased towards tradable activities; because there is no case for protecting domestic production of importables, a low border tax is preferable; the main indirect tax should be a simple tax on goods and services. Because the use of value added taxes is now so prevalent, it should be noted that they are markedly less efficient than simple sales taxes, especially in economies where tourism and other services predominate. State entrepreneurship plays a crucial role in improving international competitiveness. The starting point should be by way of leveraging existing skills, knowledge, experience and networks, retooling, repositioning and modifying products, services, processes and organisation to take advantage of emerging opportunities. Government needs to devise a comprehensive, internally cohesive and consistent strategy for maintaining and enhancing competitiveness in close collaboration with the private sector. Investment in roads, ports, airports and other transport and communications infrastructure is a vital catalyst for investment. The same is true for the supply of electricity, water, sanitation and other essential services. The speed, predictability, pertinence and courtesy which characterise public services are factors which rank highly in surveys of businesses investment. Affecting all aspects of policy is the availability – or lack thereof – of analytical tools and perspectives fashioned to the circumstances and needs of SOEs.

9. The uses of monetary policy in SOEs

This chapter describes how monetary policy may be employed in an essential but supporting role, alongside fiscal policy, in the framework of macroeconomic policy. Monetary policy tools are important because they are quick-acting, in contrast to fiscal tools which are powerful, but slow to take effect. A coordinated approach to economic shocks, deploying simultaneously fiscal tools sufficient to restore external balance and monetary tools to calm financial markets, offers the best chance of successful adjustment. The monetary authority should also offer guidance to financial markets through interest rate policy, moral suasion and information sharing. The path for domestic interest rates in small open economies is defined by the trend in the US Treasury bill rate – or other international benchmark rate – plus the costs of currency exchange and a country risk premium, which rises when there is a perceived risk of currency devaluation. Even in the absence of an active market in short-term finance – something which only a handful of countries can boast – the monetary authority can influence the domestic treasury bill rate in any desired direction through repeated intervention in a weekly auction. In this way the local rate can be kept in line with the underlying trend in the international benchmark rate. The monetary authority may then provide guidance to the market with respect to longer-term rates, using the offer rates on longer-term government bonds.

10. Finance, development and stability in the Small Open Economy

This chapter explores the relationship between the financial sector and development that improves scores on the indices that measure the quality of human lives. The first part of the chapter deals with the financing of investment, the efficiency of banking services and other credit mechanisms and the functions of capital markets, issues that directly affect employment, income spending and well-being. The second part of the chapter, on issues of financial stability, evaluates risks and mitigation strategies in terms of their potential to impair the material well-being of the population. The availability of mortgages and credit for the purchase of items of lasting value has lifted the average quality of life everywhere these facilities have been made available. The banking system broadly defined has provided a vital lubricant to trade, domestic and international, at wholesale and retail levels, through the provision of trade credit and working capital to producers, traders, distributors and the providers of transport, freight and a myriad of other supporting services. Financial failures do not appear to have inflicted any lasting damage on the well-being of countries, even in those cases where there have been well-publicised systemic failures. The public sector should aim to address the provision of equity for small and medium enterprises and for new ventures.

Weaknesses in the current state of the art in financial stability analysis include the underdeveloped nature of stress testing methodologies. In general the analysis neglects the fact that the value of capital is determined in the financial market. This creates a circular problem in thinking of systems with built-in insurance, such as the elusive notion of loss-absorbing capital. The divided international institutional framework for the assessment and surveillance of financial soundness, and for the development and implementation of regulations, is a major defect of the international system. The international surveillance of financial institutions suffers from over-reliance on elaborate lists of judgmental "standards and codes" for banking supervision, anti-money laundering, tax compliance and financial conduct evaluated by complicated and largely defective methodologies.

11. Currency unions and dollarization - The obsolescence of the currencies of SOEs

In this chapter we put the case that the domestic currencies of small open economies are an anachronism in a digital world. Currency was essential for payments when all purchases were made using notes and coins. Those days are long gone; nowadays all payments and transfers of significance are made by way of a secure instruction to transfer value from the payer's bank account to the account of the seller. Increasingly, such instructions are communicated digitally, via credit and debit cards, online bank portals, digital wallets and similar devices. The prices of imports, denominated in US dollars, determine domestic inflation in small open economies; the existence of a local currency increases the risk of excessive inflation beyond imported price increases, as a result of exchange rate depreciation. The use of the US dollar as local currency facilitates seamless payments, domestic and international.

12. A model and framework for economic policy design and implementation in SOEs

This chapter outlines a forecasting model and framework for policy making in SOEs, based on models and systems developed at the Central Bank of Barbados in the 1980s, and which have been in use at the Bank ever since, with refinements, extensions and modifications. The model follows the logic of Chapter 6, to ensure that the inferences drawn and the forecasts made are what one should expect of a small open economy. In this chapter we flesh out that skeleton to make the model directly useable to set economic targets, notably the level of foreign reserves at the central bank, and the impact on reserves of policy instruments such as central bank intervention in the foreign exchange and domestic treasury bill markets, changes in tax rates, Government borrowing at home and abroad, and other policy tools. This chapter may be considered something of a practical manual for economic policy makers in small open economies. The essential modules within the economic policy framework are:

- A model of long term investment, competitiveness and growth, which serves to provide a benchmark for the growth of competitive production capacity in the economy;

- Structural forecasting models of sectoral growth, the balance of payments, public sector revenue/current expenditure/capital expenditure/financing and the monetary accounts. Two models with similar structure are needed, a quarterly model with a rolling 18-month horizon, and an annual model with a rolling five-year horizon;

- Quarterly and annual financial control frameworks for the public sector accounts, structured to provide data that is incorporated into the forecasting framework;

- A weekly forecast for domestic and foreign currency liquidity, which is used to manage the public sector's cash requirements, consistent with the foreign reserve targets.

13. Size matters - Small economies need different strategies for stable economic development

The reasons why small open economies do best when they anchor policies for stable economic development on a targetted exchange rate are now well established in recent economic literature. However, the conventional strategy for managing the exchange rate using very large stocks of foreign reserves is costly for countries where foreign currency might be better employed for investment to increase the country's external competitiveness, beyond a small amount needed to cover seasonalities and cash flow requirements. The small open economy needs to use familiar fiscal and monetary tools to simultaneously target the exchange rate and increase the country's international competitiveness. Monetary policy should guide domestic interest rates on a path that reflects the fundamentals that are driving international benchmark rates. With respect to public sector revenue and expenditure, the similarities with large countries are that the priorities for expenditure should always be public provision of health, education, law and order and other basics of a stable, productive society that promotes human potential. Tax revenues will depend on the social consensus on the balance of taxation and public provision of public services, which varies with the preferences of each society. The differences are that the tax system of the small open economy should be biased in favour of activities that earn foreign exchange, because the growth of foreign inflows is what increases the resources available for increasing the material well-being of the population. Performance-related support for innovative export-oriented enterprise is also indicated, for similar reasons. Importantly, governments must take account of the net effects of tax and government spending policies on aggregate expenditure in the economy. Policies with respect to domestic as well as foreign borrowing should be designed to attain targets for an overall balance of external payments. The extent and nature of risk mitigation strategies against natural disasters for small open economies must be tailored to the nature of the peril, the country's average income level and the country's geography.

14. What's Wrong with Economics? The Limits of Economic Theory and Practice

Chapter 14 deals with a wide variety of issues in the practice of economics which have a bearing on the inferences we may draw from economic analysis and the advice and guidance that may be offered for economic policy. The variables in use in economics are all abstractions, conceptually and in time and space. The universally-used measure of economic activity, the gross domestic product, is "a made up entity" whose measurement is controversial and riddled with logical compromises. It is never self-evident what data is to be collected and aggregated to address any issue. Careful consideration has to be given to the options, in every case. Considerations of practicality and cost determine who collects what data and how often they do so. Careful consideration is also needed to ensure that raw data are aggregated using techniques which are most suitable for the analysis at hand. Economists have no way of establishing beyond question the impact of economic policies such as interest rate changes on intended targets such as inflation, because the impact of the policy cannot be isolated from the many other events that may be impacting the target.

Economic forecasts are an essential tool for decision makers in business and government, because they establish a benchmark against which to evaluate success or failure in implementing policy. The forecast is to guide the decision maker as to what actions are necessary to stay on course. The nation state is not always the most useful way to define an economy because national borders define patterns of production and exchange only when there are geographical, language, wars or other barriers in the way of commerce.

The subject matter of economics has to do with value in production, consumption and exchange, but the discipline has no objective measure of value. Economics struggles with issues relating to measuring variables at monthly, quarterly, annual or other intervals, ensuring that what is measured on each occasion is identical with that item as recorded on all other occasions, and the choice of methods used to draw inferences about economic relationships.

Economics continues to be in a state of internal intellectual turmoil. Chapter 14 includes summaries of some of the unconventional currents within the discipline. There is a section on evolutionary economics, the approach within our discipline which I find most appealing. We also comment on the use of terms and concepts in economics which are misleading or outmoded. Finally, we renew Diedre McCloskey's 40-year-old plea for polite, sensible, reasoned discussion among economists.

15. The small open economy - Central banking for the real world

Chapter 15 is about the role of the central bank in the framework of economic policy. Conventional views restrict the role of the central bank to the conduct of monetary policy and, in some cases, the oversight of the financial system. Chapter 15 presents the case for a much broader mandate for the central bank in small and developing countries, to include a leading role in a joined-up management of the economy as well as in the financing of investment that increases the competitiveness of the economy.

16. Sovereignty, history, geography, technology and the degrees of freedom for economic policy

Chapter 16 offers brief commentaries on the boundaries to the space for policy discretion that leaders of small nations should always be conscious of. Small countries are mistaken if they suppose that sovereignty equips them with greater economic resources than they had before they were independent nations; we explain why. The possibilities and potential for the future of the economy will have as their point of departure the patterns of wealth distribution, infrastructure, language and other endowments and legacies which history has bequeathed them. These will be unique, and lessons drawn from others will be filtered through this unique historical lens. Geography defines the nature and possibilities of the small nation's engagement with the rest of the world. The chapter also offers some comments on how small open economies might seek to reap most benefit from technological change.

17. Measuring material well-being

Chapter 17 explains why the Human Development Index is the best indicator of well-being for the purposes of evaluating the success of economic policy. The Index most closely reflects observed conditions of living in a wide variety of countries, and data are available for all countries for 20 to 30 years. The chapter explains the construction of the index in some detail, explaining the rationale for the selection of the indicators for purchasing power, health and education, and the technique by which they are combined into a single index. The HDI meets minimum standards of objectivity and it is flexible enough to incorporate additional dimensions of well-being, such as equitable income distribution, gender equality and the quality of health and educational services in countries where data are available. It follows that macroeconomic policies and strategies that use the HDI and extensions as the target they seek to attain, employing the HDI to monitor progress along the way and adjusting policies and targets where necessary, will have a greater chance of success than any other metric. What is more, evaluations of performance by economists and policy makers would have greater credibility, thanks to the match between claims of success and the lived experience of the population.

18. Globalisation is not a choice; it is a statement about our world

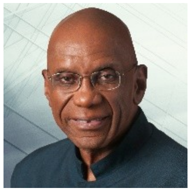
Chapter 18 is a commentary on the topic of globalisation, from the perspective of the policy maker in a small open economy. In contrast to populations in large countries, where the world outside the home country may be peripheral to their daily business activity for a large majority, the world at large, and economic exchanges with their main trading and financial partners impact daily on the economic activities of the populations of small nations. Interactions with the rest of the world may only recently have been given the title of globalisation, but those interactions have always been paramount in small open economies. Chapter 18 offers suggestions on the new opportunities that technologies have opened up and comments on emerging challenges.

The chapter concludes with suggestions for first steps in the reform of global governance. The World Bank, the International Monetary Fund and the United Nations must be the foundation for the reform of global governance because these institutions have membership of all countries. The International Monetary Fund and World Bank both have a governance structure that reflects global power relationships. A number of reforms are essential to restore the influence and effectiveness the Fund and the Bank once enjoyed. The governance structures of the United Nations and its agencies must be reformed along the lines of the Executive Boards of the Fund and the Bank. All international laws, frameworks, guidance, standards and regulations would ultimately need to be captured under the inclusive umbrella of the Fund, Bank and the United Nations.

19. Practical guidance for policy makers in small open economies

Policy makers everywhere will gain credibility from the use of the Human Development Index as the measure of economic success. It assures that there will be congruence between claims of economic success and improvements in health, education, purchasing power and other public services. It also tempers expectations: everyone will know that improvements in the quality and availability of public services, public utilities and infrastructure are not achieved overnight. Policy makers in small economies should use a model which targets their international competitiveness in a limited range of products and services, ensuring that the most affordable products and services are secured in exchange to meet their consumption and investment needs. The strategy they devise with the help of this model must be sold to the population and the investor community. There should be final and intermediate targets and a benchmark of the paths to the final targets. This benchmark should be used for ongoing monitoring and making course corrections as needed to stay on track. It is not necessary to begin with a perfect plan, nor can the outcome be predicted at the outset. However, the targets of any strategy may be attained by this process of continuous monitoring and adjustment, as policy makers and economic agents incorporate the lessons of experience.

About the author



DeLisle Worrell is a member of the Bermuda Financial Policy Council, the Bretton Woods Committee, Washington DC, and the College of Central Bankers, Federal Reserve Bank of Philadelphia. He was Governor of the Central Bank of Barbados 2009-2017. Dr Worrell founded the Bank's Research Department in 1973, and he subsequently oversaw the establishment of its Banking Supervision and Information Technology Departments. Dr Worrell spent a decade on the staff of the International Monetary Fund from 1997, and he has had fellowships at Princeton and Yale Universities, the Smithsonian Institution and the Peterson Institute (both in Washington, DC), and the US Federal Reserve. Dr Worrell is the author of *Small Island Economies: Structure and Performance in the English-speaking Caribbean Since 1970*, and author or editor of several other economic titles and numerous articles on the open economy. His Ph D in Economics is from McGill University, Montreal.